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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1942.

EDISON BROTHERS STORES, INC.,
Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 916

PETITION FOR A WRIT OF CERTIORARI

To the United States Circuit Court of Appeals
for the Eighth Circuit

and

BRIEF IN SUPPORT THEREOF.

J. SYDNEY SALKEY,
SAM ELSON,
PETER H. HUSCH,
Attorneys for Petitioner.

Of Counsel:
SALKEY & JONES,
506 Olive Street,
St. Louis, Missouri.

ST. LOUIS LAW PRINTING CO., 415 North Eighth Street. CEntral 4477.

INDEX.

Page

Petition for writ of certiorari.....1–10

Summary statement of the matter involved..... 1

Preliminary statement 1
Questions presented 2
Facts 2
Commissioner's position 5
Petitioner's position 5

Jurisdiction 6
Reasons relied on for allowance of writ..... 6
Prayer for writ 9

Brief in support of petition for certiorari.....11-32

Opinions of the Court and Board below..... 11
Jurisdiction 11
Statement 11
Specification of errors 11
Points and authorities 13
Argument 16

1. In holding that petitioner realized taxable income from the acquisition and subsequent sale of its own stock, and that the prior regulations dealing with transactions of that character were erroneous, the decision of the Circuit Court of Appeals is directly in conflict with applicable decisions of this Court 16

2. In holding that the treasury department has the power, merely by amending its regulations, to change a valid, long settled construction of a statute which has been given the force of law by Congress, the decision of the Circuit Court of Appeals directly conflicts with other applicable decisions of this Court 19

136395

3. In holding that the acquisition and subsequent sale by a corporation of shares of its own capital stock can result in taxable income, the Circuit Court of Appeals has decided an important and fundamental question of federal constitutional law which, if it has not already been decided, as we contend, by this Court, should now be decided by this Court 21

4. In holding that a ruling or requirement of a branch of the Federal Government having regulatory powers over a taxpayer with regard to the treatment by it of its securities is not binding upon the Bureau of Internal Revenue, the Circuit Court of Appeals has rendered a decision in conflict with decisions of other Circuit Courts of Appeals on this question 22

5. In relying on certain decisions of this Court which petitioner believes to be inapplicable to this case, the Circuit Court of Appeals has added to the confusion surrounding the important question as to the scope of power of administrative bodies to amend their interpretative regulations, which question should be clarified and settled by this Court 26

6. In holding that petitioner was dealing in its own shares as it might in the shares of another corporation, the Circuit Court of Appeals has sanctioned a distortion of the clear language and intent of the treasury regulations which should be rectified by this Court..... 27

Conclusion 32

Cases Cited.

Citizens Nat. Bank of Orange v. Commissioner (1935, C. C. A. 4), 74 F. (2d) 604, 605 ..... 8, 14, 24

Douglas v. Willcuts (1935), 296 U. S. 1, 9 ..... 13, 18

D. N. & E. Walter & Co. v. Commissioner, 1942 B. T. A. Memo. (C. C. H.—B. T. A. Service, Decision 12,576-B) 15, 30

First Chrold Corporation v. Commissioner (1939), 306 U. S. 117 ..... 6, 7, 13, 16, 18, 19

Helvering v. Clifford (1940), 309 U. S. 331, 334 ..... 13, 18

Helvering v. Griffiths (1943), ... U. S. ..., 63 Sup. Ct. 636, 87 L. Ed. Adv. Op. 597, 611 ..... 9, 15, 26

Helvering v. Janney (1940), 311 U. S. 189 ..... 7, 13, 20, 21

Helvering v. Oregon Mutual Life Insurance Co. (1940), 311 U. S. 267 ..... 7, 13, 19, 20, 21

Helvering v. Reynolds (1941), 313 U. S. 428 .... 8, 15, 26, 27

Helvering v. R. J. Reynolds Tobacco Co. (1939), 306 U. S. 110 ..... 6, 7, 13, 14, 16, 18, 19, 20, 22, 26

Helvering v. Wilshire Oil Co. (1939), 308 U. S. 90 .. 8, 15, 26

Helvering v. Winmill (1938), 305 U. S. 79, 83 ..... 13, 19

Irwin v. Gavit (1925), 268 U. S. 161, 166 ..... 13, 18

Koshland v. Helvering (1936), 298 U. S. 441, 445 ..... 13, 14, 18, 21

Morgan v. Commissioner (1940), 309 U. S. 78, l. c. 81 .. 19

Morrill v. Jones (1883), 106 U. S. 466 ..... 7, 13, 20, 21

Morrissey v. Commissioner (1937), 296 U. S. 344 ... 8, 15, 26

United States v. Beckman (1939, C. C. A. 3), 104 F. (2d) 260, 264 ..... 8, 14, 25

Statutes Cited.

Article 22 (a)-16 of Treasury Regulations 86 and 94 ..... 15, 27, 28

Articles 542 and 563 of Treasury Regulations 45 through Articles 66 and 176 of Treasury Regulations 77 ..... 13, 17

Judicial Code, Sec. 240 (a), as amended by Act of Feb. 13, 1925, 43 Stat. 938 [28 U. S. C., Sec. 347 (a)] 6

Section 22 (a) of the Revenue Acts of 1928, 1932, 1934 and 1936 ..... 13, 17

Miscellaneous.

S. E. C. Accounting Series, Release No. 6, issued May 10, 1938 ..... 14, 22, 23

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Respondent.

No. .....

PETITION FOR WRIT OF CERTIORARI.

To The Honorable Chief Justice And Associate Justices Of The Supreme Court Of The United States:

Your petitioner, Edison Brothers Stores, Inc., a corporation, respectfully shows to this Honorable Court the following:

A.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

PRELIMINARY STATEMENT.

This case arose on cross appeals taken from a decision of the United States Board of Tax Appeals entered on November 25, 1941 (R. 26-34), and reported in 45 B. T. A. 472. The matters in controversy are alleged deficiencies in federal income taxes for the calendar years 1935 and 1937 in the amounts of $1,553.74 and $10,312.15, respectively. The Commissioner was appealing from that por-

tion of the Board's decision which held that there was no deficiency for 1935, and your petitioner, Edison Brothers Stores, Inc., was appealing from so much of the Board's decision as found that there was a deficiency for 1937. The case came to the Circuit Court of Appeals for the Eighth Circuit on cross petitions for review (R. 34 and 40), duly filed by the respective parties pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code, and consolidated for purposes of record, briefing, hearing and decision by order of that Court entered March 7, 1942 (R. 49-50). The judgment of the Circuit Court of Appeals rendered on February 3, 1943 (R. 69-70), reversed the decision of the Board with respect to its finding of no deficiency for the year 1935, and affirmed the Board's decision with respect to its finding of the deficiency asserted for the year 1937. The opinion of the Circuit Court of Appeals is printed on pages 56-68 of the Record.

QUESTIONS PRESENTED.

The questions presented are, first, whether petitioner realized taxable income in either or both of the years involved from the sale by it of shares of its own capital stock to certain of its employees pursuant to employees' stock subscription plans; and, second, whether the company was entitled to deduct the fair market value of certain shares of its own stock which it transferred to its general counsel in 1935 in payment of a bill for services rendered.

FACTS.

There is no dispute as to the facts, all of them having been agreed to by the parties in a Stipulation of Facts filed with the Board of Tax Appeals at the time the case was heard (R. 18-26). Briefly summarized, they are as follows:

Edison Brothers Stores, Inc., was incorporated on March 13, 1929, under the laws of the State of Delaware. A few weeks before the actual incorporation, however, the five Edison brothers, who were the founders and original incorporators of the company, entered into an underwriting agreement with a brokerage house whereby they subscribed to the entire issue of its common stock, consisting of 100,000 shares of no par value, but agreed that they would immediately resell, through the underwriters, 5,000 shares to the company for the purpose of sale and distribution to its employees, and another 20,000 shares to the general public. Thus, in accordance with this preincorporation agreement, the company immediately acquired 5,000 shares of its own stock, at a price to it of $15.00 per share, which it designated as "Capital stock purchased for resale to employees" (R. 19).

Thereafter, during the same year, a substantial portion of this stock was allotted to certain key employees, under a stock subscription plan, at a price of $15.00 a share, payable in installments over a period of time. Subsequently, in 1932, at the depth of the depression, the company voluntarily reduced the original subscription price from $15.00 to $7.50 a share to compensate for the drastic decline in its market value, this adjustment being made on all shares originally subscribed for, except, of course, those for which subscriptions had been canceled. Those employees who had overpaid on the basis of this adjustment were given the option of taking a cash refund or additional shares at the reduced price. This resulted in the issuance of nearly 200 more shares to such employees. Another 760 shares were given to employees in 1933 in the form of bonuses (R. 19-20).

During the year 1935 the company allotted and sold 980 shares of this same stock to certain of its employees at a price to them of $25.00 a share, although the market

price at the time of the sale was $30.00 a share (R. 20). This allotment was likewise made pursuant to an employees' stock subscription plan, the terms of which are fully set forth in Exhibit B of the stipulation of facts (R. 22-24). At about the same time the company transferred another 100 shares of its stock to its general counsel, Mr. George Frankenthaler, of New York City (who was and still is also one of the directors of the company) in payment of a $3,000.00 bill for services rendered (R. 20).

In the early part of 1937, pursuant to a reorganization of the corporation's capital structure, its common stock was split up on a basis of three shares of new $2.00 par value common stock for each one share of the old no par common, thus reducing the company's cost to $5.00 per share (R. 21). Later in the year the company allotted and sold 3,660 shares of this new stock to its employees at a price of $15.00 a share, pursuant to another employees stock subscription agreement (R. 21), a form of which appears as Exhibit C of the stipulation of facts (R. 25).

The Commissioner asserted deficiencies in income taxes for the years 1935 and 1937 (R. 7 and 14) on the ground, first, that the company should have included as taxable income in those years the difference of $10.00 a share between the price at which it acquired those shares at the time of its incorporation and the price at which they were allotted and sold to its employees under the stock subscription plans, and, second, that the company was not entitled to deduct the full market value of those shares which it used in 1935 to discharge its obligation to its general counsel and director for services rendered, but was limited to a deduction of the amount which it had paid for those shares.

Petitioner filed petitions to the United States Board of Tax Appeals for a redetermination of the deficiencies for both years (R. 3 and 12), and, as already indicated, the Board decided these issues in favor of the taxpayer for

the year 1935 and in favor of the Commissioner of Internal Revenue for the year 1937; and the Circuit Court of Appeals has reversed the Board for the year 1935 and has affirmed it for the year 1937, having decided in favor of the Commissioner for both years.

COMMISSIONER'S POSITION.

The Commissioner based his determination of deficiencies on the ground that, in the acquisition of these shares at the time of its incorporation and the subsequent disposition thereof to its employees in 1935 and 1937, petitioner was dealing in its own shares as it might in the shares of another corporation within the meaning of Article 22 (a)-16 of Treasury Regulations 86 and 94 purporting to interpret the meaning of Section 22 (a) of the Revenue Acts of 1934 and 1936.

PETITIONER'S POSITION.

The position which petitioner has maintained throughout these proceedings is:

(1) That the sale by a corporation of shares of its own capital stock which it had previously acquired and held in its treasury is a purely capital transaction resulting in the acquisition of capital and not income.

(2) That such a sale is just as much a capital transaction as the sale of authorized but unissued stock; and that therefore a corporation cannot realize taxable gain from such a sale of treasury stock.

(3) That the prior Regulations which so held for over fourteen years were not only a proper interpretation of Section 22 (a) but were given the force and effect of law by the repeated re-enactment by Congress of Section 22 (a) without change.

(4) That in so far as the amended Regulations promulgated under the Revenue Acts of 1934 and 1936 purport to

change the prior interpretation of Section 22 (a) they must be held invalid as an administrative attempt to usurp the legislative function of Congress.

(5) That petitioner was not in any sense dealing in the shares of its own stock as it might in the shares of another corporation and that hence the amended Regulations, even if valid, have no application to the transactions here involved.

B.

JURISDICTION.

Jurisdiction to review the judgment of the Circuit Court of Appeals in this case is conferred upon this Court by the provisions of Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 [28 United States Code, Section 347 (a)].

The judgment of the Circuit Court of Appeals for the Eighth Circuit was rendered on February 3, 1943 (R. 69-70), and the petition for rehearing (R. 71-81) was denied on March 3, 1943 (R. 83).

C.

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

1.

In holding that petitioner realized taxable income from the acquisition and subsequent sale of its own stock, the Circuit Court of Appeals has decided a federal question in a way directly in conflict with the controlling decisions of this Court in *Helvering v. R. J. Reynolds Tobacco Co.* (1939), 306 U. S. 110, and *First Chrold Corporation v. Commissioner* (1939), 306 U. S. 117.

2.

In holding that the prior Treasury Regulations dealing with the acquisition and sale by a corporation of shares of its own stock were erroneous, the Circuit Court of Appeals has decided a federal question in a way also in direct conflict with the holding of this Court in *Helvering v. R. J. Reynolds Tobacco Co.*, supra, and *First Chrold Corporation v. Commissioner*, supra.

3.

In holding that the Treasury Department has the power, merely by amending its regulations, to change a construction of a statute which has been given the force of law by Congress by virtue of the repeated re-enactment of the statute without change in the light of a consistent interpretation thereof contained in such regulations over a long period of years, the Circuit Court of Appeals has decided a federal question in a way directly in conflict with the decisions of this Court in *Morrill v. Jones* (1883), 106 U. S. 466; *Helvering v. Janney* (1940), 311 U. S. 189, and *Helvering v. Oregon Mutual Life Insurance Co.* (1940), 311 U. S. 267.

4.

In holding that a corporation can realize taxable income from the acquisition and subsequent sale of shares of its own capital stock, the Circuit Court of Appeals has decided an extremely important question of federal law which, if it has not already been settled, as we contend, by the decisions of this Court in *Helvering v. R. J. Reynolds Tobacco Co.*, supra, and *First Chrold Corporation v. Commissioner*, supra, should be conclusively settled by this Court.

5.

In holding that a ruling or requirement of one branch of the federal government (in this case the Securities and Exchange Commission, which has ruled that the acquisition and subsequent resale by a corporation of its own stock is a capital transaction and requires that any surplus arising therefrom be treated as capital) having regulatory power over a taxpayer with regard to the treatment by it of its securities is not binding upon the Bureau of Internal Revenue, the Circuit Court of Appeals has rendered a decision in conflict with the decisions of the Circuit Courts of Appeals for the Third and Fourth Circuits in *Citizens' National Bank of Orange v. Commissioner* (1935, C. C. A. 4), 74 F. (2d) 604, and *United States v. Beckman* (1939, C. C. A. 3), 104 F. (2d) 260, 264.

6.

In relying on the decisions of this Court in *Morrissey v. Commissioner* (1937), 296 U. S. 344; *Helvering v. Wilshire Oil Co.* (1939), 308 U. S. 90, and *Helvering v. Reynolds* (1941), 313 U. S. 428, as being applicable to the case at bar, the Circuit Court of Appeals has misinterpreted the true holdings of those decisions and has thereby added to the general confusion as to the scope of the power of the Treasury Department to amend its regulations under varying circumstances, and in so doing has, among other things, completely failed to note the important distinction between legislative and interpretative regulations, and between amendments which merely amplify or clarify a recognized construction and those which attempt to change an interpretation which has acquired the force of law. The entire subject of regulatory powers of administrative agencies in general, and of the Treasury Department in particular, is in a state of considerable confusion (as recently observed by this Court

in *Helvering v. Griffiths* (1943), ... U. S. ..., 63 Sup. Ct. 636, 87 L. Ed. Adv. Op. 597, l. c. 611) and is a federal question of extreme importance which should be clarified and settled by this Court.

7.

In upholding the Commissioner's contention that petitioner was here dealing in its own shares as it might in the shares of another corporation, while at the same time conceding that the stock of no other corporation could possibly have served the purpose for which these shares were acquired and sold, the Circuit Court of Appeals has sanctioned the emasculation of the express language of the revised regulation, and in doing so has erroneously decided an important question of federal law which has not been but which should be decided by this Court.

D.

PRAYER FOR WRIT.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Eighth Circuit, commanding that Court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the causes entitled and numbered on its docket, Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, v. Edison Brothers Stores, Inc., Respondent, No. 12,250, Tax Review, and Edison Brothers Stores, Inc., Petitioner, v. Guy T. Helvering, Commissioner of Internal Revenue, Respondent, No. 12,251, Tax Review; that the judgment of the Circuit Court of Appeals for the Eighth Circuit in said causes may be reviewed

by this Honorable Court; and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

Respectfully submitted,

EDISON BROTHERS STORES, INC.,

By J. SYDNEY SALKEY,
SAM ELSON,
PETER H. HUSCH,
Attorneys for Petitioner.

Of Counsel:

SALKEY & JONES,
506 Olive Street,
St. Louis, Missouri.

April 10, 1943.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

I.

OPINIONS OF THE COURT AND BOARD BELOW.

The opinion of the United States Circuit Court of Appeals for the Eighth Circuit is not yet officially reported, but is set out on pages 56-68 of the Record. The opinion of the United States Board of Tax Appeals is reported in 45 B. T. A. 472 and appears in the Record at pages 26-34.

II.

JURISDICTION.

A concise statement of the grounds on which the jurisdiction of this Court is invoked appears under the headings B and C in the petition for certiorari, ante, and in the interest of brevity is not repeated here.

III.

STATEMENT.

A concise statement of the case containing all that is material to the consideration of the questions presented, including a summary of the questions presented, the respondent's position and the position of the petitioner, is set out under heading A of the petition for certiorari, ante, and in the interest of brevity is not repeated here.

IV.

SPECIFICATION OF ERRORS.

1. The Circuit Court of Appeals erred in holding that petitioner realized taxable income within the meaning of Section 22 (a) of the Revenue Acts of 1934 and 1936 from the sale of its own stock to its employees in 1935 and 1937.

2. The Circuit Court of Appeals erred in holding that petitioner was not entitled to a deduction in 1935 in the amount of the fair market value of the shares of its own stock which it transferred to its general counsel in payment for services rendered.

3. The Circuit Court of Appeals erred in failing to hold that the sale or other disposition by a corporation of shares of its own previously acquired capital stock is a purely capital transaction resulting in the acquisition of capital and not income.

4. The Circuit Court of Appeals erred in failing to hold that a corporation realizes no taxable gain or loss from the purchase and sale of its own stock.

5. The Circuit Court of Appeals erred in holding that Article 22 (a)-16 of Treasury Regulations 86 and 94 were intended to change the prior, well settled construction of Section 22 (a) with respect to the sale of treasury stock.

6. The Circuit Court of Appeals erred in failing to hold that the prior construction of Section 22 (a), having been given the force of law by Congress, could be changed only by action of Congress, and that therefore the revised regulations, to the extent that they do purport to change the established meaning of Section 22 (a), are invalid.

7. The Circuit Court of Appeals erred in holding that petitioner was dealing in its own stock as it might in the shares of another corporation, within the meaning of Article 22 (a)-16 of Treasury Regulations 86 and 94.

8. The Circuit Court of Appeals erred in reversing the decision of the Board of Tax Appeals with respect to the year 1935 and in affirming the decision of the Board with respect to the year 1937.

9. The Circuit Court of Appeals erred in failing and refusing to decide that there are no deficiencies in petitioner's income tax for either of the years involved.

V.

POINTS AND AUTHORITIES.

1.

In holding that petitioner realized taxable income from the acquisition and subsequent sale of its own stock, and that the prior regulations dealing with transactions of that character were erroneous, the decision of the Circuit Court of Appeals is directly in conflict with applicable decisions of this Court.

Section 22 (a) of the Revenue Acts of 1928, 1932, 1934 and 1936;
Articles 542 and 563 of Treasury Regulations 45 through Articles 66 and 176 of Treasury Regulations 77;
Helvering v. R. J. Reynolds Tobacco Co. (1939), 306 U. S. 110;
First Chrold Corporation v. Commissioner (1939), 306 U. S. 117;
Irwin v. Gavit (1925), 268 U. S. 161, 166;
Douglas v. Willcuts (1935), 296 U. S. 1, 9;
Helvering v. Clifford (1940), 309 U. S. 331, 334;
Koshland v. Helvering (1936), 298 U. S. 441, 445.

2.

In holding that the Treasury Department has the power, merely by amending its regulations, to change a valid, long-settled construction of a statute which has been given the force of law by Congress, the decision of the Circuit Court of Appeals directly conflicts with other applicable decisions of this Court.

Helvering v. R. J. Reynolds Tobacco Co. (1939), 306 U. S. 110;
Helvering v. Winmill (1938), 305 U. S. 79, 83;
Helvering v. Oregon Mutual Life Insurance Co. (1940), 311 U. S. 267;
Helvering v. Janney (1940), 311 U. S. 189;
Morrill v. Jones (1883), 106 U. S. 466.

3.

In holding that the acquisition and subsequent sale by a corporation of shares of its own capital stock can result in taxable income, the Circuit Court of Appeals has decided an important and fundamental question of federal constitutional law which, if it has not already been decided, as we contend, by this Court, should now be decided by this Court.

Helvering v. R. J. Reynolds Tobacco Co. (1939), 306 U. S. 110;
Koshland v. Helvering (1936), 298 U. S. 441, 445.

4.

In holding that a ruling or requirement of a branch of the federal government having regulatory powers over a taxpayer with regard to the treatment by it of its securities is not binding upon the Bureau of Internal Revenue, the Circuit Court of Appeals has rendered a decision in conflict with decisions of other Circuit Courts of Appeals on this question.

S. E. C. Accounting Series, Release No. 6, issued May 10, 1938;
Citizens Nat. Bank of Orange v. Commissioner (1935, C. C. A. 4), 74 F. (2d) 604, 605;
United States v. Beckman (1939, C. C. A. 3), 104 F. (2d) 260, 264.

5.

In relying on certain decisions of this Court which petitioner believes to be inapplicable to this case, the Circuit Court of Appeals has added to the confusion surrounding the important question as to the scope of power of administrative bodies to amend their interpretative regulations,

which question should be clarified and settled by this Court.

Helvering v. Griffiths (1943), ... U. S. ..., 63 Sup. Ct. 636, 87 L. Ed. Adv. Op. 597, 611;
Morrissey v. Commissioner (1937), 296 U. S. 344;
Helvering v. Wilshire Oil Co. (1939), 308 U. S. 90;
Helvering v. Reynolds (1941), 313 U. S. 428.

6.

In holding that petitioner was dealing in its own shares as it might in the shares of another corporation, the Circuit Court of Appeals has sanctioned a distortion of the clear language and intent of the Treasury Regulations which should be rectified by this Court.

Article 22 (a)-16 of Treasury Regulations 86 and 94;
D. N. & E. Walter & Co. v. Commissioner, 1942 B. T. A. Memo. (C. C. H.—B. T. A. Service, Decision 12,576-B).

VI.

ARGUMENT.

1.

In Holding That Petitioner Realized Taxable Income From The Acquisition And Subsequent Sale Of Its Own Stock, And That The Prior Regulations Dealing With Transactions Of That Character Were Erroneous, The Decision Of The Circuit Court Of Appeals Is Directly In Conflict With Applicable Decisions Of This Court.

In *Helvering v. R. J. Reynolds Tobacco Co.* (1939), 306 U. S. 110, and *First Chrold Corporation v. Commissioner* (1939), 306 U. S. 117, this Court held that the respective corporations realized no taxable income from the sales of their own treasury stock in the years 1929 and 1933, respectively. There can be no question that this was the express holding of those decisions, for in the opening paragraph of its opinion in the *Reynolds* case, this Court stated, 306 U. S., l. c. 111:

> "The sole question for decision is whether gain accruing to a corporation consequent on the purchase and resale of its own shares constitutes gross income within the meaning of Section 22 (a) of the Revenue Act of 1928."

Similarly, the first sentence of the opinion in the *First Chrold* case, decided in accordance with the holding in the *Reynolds* case, says, 306 U. S., l. c. 118:

> "This case presents the same question as that involved in No. 328 [the *Reynolds* case], decided this day."

Thus, in the only decisions of this Court on this precise point, we have two express holdings that "gain accruing to a corporation consequent on the purchase and resale of its own shares" does **not** constitute "gross income within

the meaning of Section 22 (a)" of the Revenue Acts of 1928 and 1932. Yet the decision of the Circuit Court of Appeals finds that exactly the same types of transaction **do** give rise to taxable income within the meaning of Section 22 (a) of the Revenue Acts of 1934 and 1936. This holding cannot be reconciled with the decisions of this Court.

The applicable provisions of Section 22 (a) of the Revenue Acts of 1928, 1932, 1934 and 1936 are identical. Indeed, the definition of gross income in Section 22 (a) has remained substantially unchanged since its adoption as Section II-B of the Revenue Act of 1913. It reads, so far as material to this case, as follows:

> "Sec. 22. GROSS INCOME.
>
> "(a) **General Definition.**—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

For more than fourteen years prior to May 2, 1934, the Treasury Regulations interpreting that section with respect to the sale by a corporation of its own capital stock had read, so far as material, substantially as follows (Articles 542 and 563 of Regulations 45, through Articles 66 and 176 of Regulations 77):

> "**Sale by corporation of its capital stock.**— * * * or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not con-

stitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock."

It has been conclusively established by numerous decisions of this Court that the broad sweep of the language of Section 22 (a) indicates the purpose of Congress to use the full measure of its taxing power under the Sixteenth Amendment.

Irwin v. Gavit (1925), 268 U. S. 161, 166;
Douglas v. Willcuts (1935), 296 U. S. 1, 9;
Helvering v. Clifford (1940), 309 U. S. 331, 334.

It is likewise well established that the act of Congress alone fixes the rights and liabilities of taxpayers, to which the Treasury Department can neither add nor detract by its administrative regulations. The Act itself, and not the interpretation, is the ultimate source of those rights and liabilities. Cf. *Koshland v. Helvering* (1936), 298 U. S. 441, l. c. 445 et seq.

Thus, if capital stock transactions of this character gave rise to income under the Sixteenth Amendment, this Court would have been compelled to have decided the *Reynolds Tobacco Co.* case and the *First Chrold Corporation* case the other way, despite the long-standing interpretation of Section 22 (a) to the contrary in the regulations prior to 1934. *Koshland v. Helvering,* supra. The necessary implication of those decisions, therefore, is that those transactions did **not** result in taxable income and that the prior regulations holding them to be capital transactions were valid and proper. In fact, the propriety of the earlier regulations was expressly upheld by this Court in the *Reynolds* case (306 U. S., l. c. 114).

This being the case, the holding of the Circuit Court of Appeals in the case at bar that similar transactions in 1935 and 1937 did result in taxable income and that the

prior regulations to the contrary were erroneous is directly in conflict with the decisions of this Court in the *Reynolds Tobacco Co.* and *First Chrold Corporation* cases, supra.

2.

In Holding That the Treasury Department Has the Power, Merely by Amending Its Regulations, to Change a Valid, Long Settled Construction of a Statute Which Has Been Given the Force of Law by Congress, the Decision of the Circuit Court of Appeals Directly Conflicts With Other Applicable Decisions of This Court.

This Court not only expressly held, in *Helvering v. R. J. Reynolds Tobacco Co.* (1939), 306 U. S. 110, that the prior regulations were a proper interpretation of Section 22 (a) but also that Congress, by the repeated re-enactment of Section 22 (a) without change in the light of that consistent interpretation over a long period of years, "must be taken to have approved the administrative construction **and thereby to have given it the force of law"** (306 U. S., l. c. 114). This rule of legislative adoption of valid, consistent and long standing administrative interpretations is supported by numerous decisions of this Court, of which two of the more recent are *Helvering v. Winmill* (1938), 305 U. S. 79, l. c. 83, and *Morgan v. Commissioner* (1940), 309 U. S. 78, l. c. 81.

It is equally well settled that where the meaning of a statute has been established by an administrative construction which has thus acquired the force and effect of law that meaning can be changed only by Congress itself, and not by an administrative agency charged merely with carrying out the intention of the legislative body. For example, in *Helvering v. Oregon Mutual Life Insurance Co.* (1940), 311 U. S. 267, where after thirteen years of consistent administrative regulation and practice the Treasury Department had, as in the case at bar, sought

to reverse its prior construction by amending its regulations, this Court held that the meaning of the Act could be changed only by Congress, saying, through Mr. Justice Black, 311 U. S., l. c. 272:

> "For it is our conclusion that by Sec. 203 (a) (2) of the 1932 and 1934 Acts, Congress has granted life insurance companies a deduction for disability reserves **which only Congress can take away.**"

Similarly, in *Helvering v. Janney* (1940), 311 U. S. 189, involving a change in the regulations governing the deductibility of capital losses of one spouse from the capital gains of the other in a joint return, Mr. Chief Justice Hughes, speaking for this Court, concludes, 311 U. S., l. c. 194:

> "We are of the opinion that under the provisions of the Act of 1934 as to joint returns of husband and wife, which embodied a policy set forth in substantially the same terms for many years, Congress intended [etc.] * * *. This, we think, was the meaning of the provision of the Revenue Act of 1934 when it was enacted, and **it was subject to change only by Congress, and not by the Department.**"

Likewise, in *Morrill v. Jones* (1883), 106 U. S. 466, this Court said:

> "The Secretary of the Treasury cannot by his regulations alter or amend the law. All he can do is to regulate the mode of proceeding to carry into effect what Congress has enacted. * * * In our opinion, the object of the Secretary could only be accomplished by an amendment of the law. That is not the office of a treasury regulation."

Therefore, since (as was expressly held by this Court in *Helvering v. R. J. Reynolds Tobacco Co.*, supra) the prior regulations dealing with the sale by a corporation

of its own stock were a proper interpretation of Section 22 (a) and as such had been given the force and effect of law by Congress, that interpretation could be changed only by Congress and not by the Department; and the holding of the Circuit Court of Appeals to the contrary in this case is directly in conflict with the decisions of this Court in *Helvering v. Oregon Mutual Life Insurance Company*, *Helvering v. Janney*, and *Morrill v. Jones*, supra.

3.

In Holding That the Acquisition and Subsequent Sale by a Corporation of Shares of Its Own Capital Stock Can Result in Taxable Income, the Circuit Court of Appeals Has Decided an Important and Fundamental Question of Federal Constitutional Law Which, If It Has Not Already Been Decided, as We Contend, by This Court, Should Now Be Decided by This Court.

The question of whether or not the sale of treasury stock by a corporation is essentially a capital transaction resulting only in the acquisition of capital and not income is one of extreme importance in the law of federal taxation. For if such transactions are purely capital in nature and the amended regulations as applied by the Commissioner are allowed to stand, the effect will be to permit the imposition of a direct tax on capital in violation of Article I of the Constitution of the United States and beyond the scope of the Sixteenth Amendment of the Constitution of the United States. To paraphrase slightly the language of this Court in *Koshland v. Helvering*, supra, 298 U. S. 441, l. c. 445:

> "The question here," therefore, "is not merely of" the adoption by Congress or by this Court of the changed "administrative construction, but whether it should be adopted if in effect it converts an income tax into a capital levy."

We contend that this question has been conclusively resolved by the decision of this Court in *Helvering v. R. J. Reynolds Tobacco Co.*, supra, 306 U. S. 110, for the reasons set forth under Point I, ante, and that therefore the decision of the Circuit Court of Appeals is in complete and direct conflict with that case and should be reversed. If, however, in view of certain qualifying language of the opinion in the *Reynolds* case, this Court should be of the opinion that it has not passed on this precise question it should do so now; for to deny certiorari in this case, and thus presumptively leave this question open, will necessarily result in the imposition of a tax which may ultimately be held to be an unconstitutional levy of a direct tax on capital as and when this question is finally decided by this Court. We therefore strongly urge the Court to take jurisdiction in this case if for no other reason than that of clearly settling this extremely important, fundamental question of federal constitutional law.

4.

In Holding That a Ruling or Requirement of a Branch of the Federal Government Having Regulatory Powers Over a Taxpayer With Regard to the Treatment by It of Its Securities Is Not Binding Upon the Bureau of Internal Revenue, the Circuit Court of Appeals Has Rendered a Decision in Conflict With Decisions of Other Circuit Courts of Appeals on This Question.

The capital stock of petitioner is listed on the New York Stock Exchange, and petitioner is and was during the years here involved registered with the Federal Securities and Exchange Commission. As a registrant it is, of course, subject to the rules and regulations of that body with respect to the treatment of its securities. Of primary importance therefore is the following ruling contained in S. E. C. Accounting Series, Release No. 6, issued May 10, 1938:

"Question has been raised with respect to the proper treatment of an item of $488,211.83 representing 'Excess of proceeds from sale of 12,200 reacquired shares of the company's capital stock over the cost thereof.' These shares represent part of 41,400 shares of the capital stock of the registrant, a manufacturing company, reacquired by it prior to the year 1934 'for the purpose of resale when market conditions improved.'

"Under the laws of most states there are certain legal restraints upon the issuance of new shares that do not apply to the sale of treasury shares. **However, from an accounting standpoint, there appears to be no significant difference in the final effect upon the company between (1) the reacquisition and resale of a company's own common stock and (2) the reacquisition and retirement of such stock, together with the subsequent issuance of stock of the same class.**

"It is recognized that when capital stock is reacquired and retired any surplus arising therefrom is capital and should be accounted for as such, and that the full proceeds of any subsequent issue should also be treated as capital. Transactions of this nature do not result in corporate profits or in earned surplus. **There would seem to be no logical reason why surplus arising from the reacquisition of the company's capital stock and its subsequent resale should not also be treated as capital.**

"In my opinion the $488,211.83 excess of proceeds from the sale of 12,200 reacquired shares of this registrant's capital stock over the cost thereof **should be treated as capital stock or capital surplus as the circumstances require.**" (Emphasis ours.)

Viewing the matter from a realistic point of view, controlling consideration should be given to the fact that petitioner, being a registered corporation, was and is required by the Securities and Exchange Commission, in conformance with the foregoing ruling, to treat any surplus arising from the sale of these reacquired shares of its

own stock as capital and not as "profits or earned surplus." And the rule is well settled that a ruling or requirement of one branch of the government having regulatory power over the taxpayer with regard to the treatment by it of its securities is binding upon another branch of the government, and particularly upon the Bureau of Internal Revenue.

Thus, in *Citizens' Nat. Bank of Orange v. Commissioner* (1935, C. C. A. 4), 74 F. (2d) 604, a bank which was ordered by the national bank examiner to write down certain of its bonds, solely for the reason that their market values had declined materially, was held entitled to deduct the full amount of the write-down despite the fact that at the close of the year none of the bonds were in default and there was no indication that any of the bonds would not be collected at maturity. The Court said, l. c. 605:

> "Here we have a case in which one branch of the government can compel the taxpayer to take an action with regard to its securities which, when taken, will not be recognized by another branch of the government. This is not fair to the taxpayer. There should be at least some semblance of co-ordination between the several branches of the government in dealing with a taxpayer. It is immaterial as to what reason the bank examiner gave for ordering the charge off. His determination that the bonds were worthless in part was sufficient. The bank was under the necessity of complying with the instructions given, and it seems only reasonable that the bank should be allowed, in its return for the purposes of taxation, a deduction, corresponding in amount to the charge off made under compulsion. Otherwise the bank would be compelled to keep two sets of books, one, as directed by the bank examiner, and the other for the purpose of making its tax return."

And in conclusion the Court said, l. c. 606:

> "It is also contended on behalf of the respondent that fluctuations in the market values do not justify

> deductions, and with this contention we agree, but here the deduction was not made by the bank because of market fluctuations, but because of the order of the bank examiner, and, as we stated above, it is immaterial what reason the bank examiner gave for his action. The bank was, in any event, obliged to follow the examiner's orders."

This doctrine is applied to taxpayer and tax collector alike, as evidenced by the decision of the Third Circuit in *United States v. Beckman* (1939, C. C. A. 3), 104 F. (2d) 260, l. c. 264, where the rule was successfully invoked by the Commissioner of Internal Revenue. This eminently just and equitable doctrine has, we submit, an even stronger application to the case at bar than to the cases above cited. For, in the *Citizens' Bank* case, the controversy revolved about the disallowance of a claimed deduction, the permissibility of which is, after all, purely a matter of legislative grace; whereas, in the instant case we are directly concerned with the constitutional limitation of the power of Congress to tax only income, in a case where the Commissioner is claiming as additional income something which that branch of the government having regulatory power and control over the financial operations of the taxpayer states unequivocally to be capital and which is required to be treated as such by the corporation. Yet the Circuit Court of Appeals in our case states (R. 62):

> "Nor can the ruling of one administrative department of the government concerning income accounting control that of another department made for an entirely different purpose under another act of Congress."

In so deciding, the Circuit Court of Appeals for the Eighth Circuit is in direct conflict with the foregoing decisions of the Circuit Courts of Appeal for the Third and Fourth Circuits.

5.

In Relying On Certain Decisions Of This Court Which Petitioner Believes To Be Inapplicable To This Case, The Circuit Court Of Appeals Has Added To The Confusion Surrounding The Important Question As To The Scope Of Power Of Administrative Bodies To Amend Their Interpretative Regulations, Which Question Should Be Clarified and Settled By This Court.

Recognition of the general confusion that now exists, not only in the legal profession but in the Courts as well, with respect to the power of the Treasury Department to amend its regulations under varying circumstances is to be found in the recent opinion of this Court in *Helvering v. Griffiths* (1943), ... U. S. ..., 63 Sup. Ct. 636, 87 L. Ed. Adv. Op. 597, l. c. 611-612, where attention is called in footnote 47, to the various and not entirely consistent terms in which the question has been discussed by this Court and where it is expressly noted that the question of the power to make prospective amendments had been left open in the *R. J. Reynolds Tobacco Co.* case, supra, 306 U. S. 311, 316-317. The question is one of the greatest importance, albeit of considerable difficulty, and is directly raised in this case and should now be settled by this Court, so that some of the uncertainty, to which this Court has itself pleaded guilty, as aforesaid, in the *Griffiths* case, supra, may be laid at rest.

Certainly, the decision of the Circuit Court of Appeals in this case has considerably added to the general confusion, for in its apparent reliance on the decisions in *Morrissey v. Commissioner* (1937), 296 U. S. 344; *Helvering v. Wilshire Oil Co.* (1939), 308 U. S. 90, and *Helvering v. Reynolds* (1941), 313 U. S. 428, the Court has indicated an almost complete misconception of the true holding of those cases.

The *Morrissey* case involved an amended regulation

which merely clarified the earlier regulations and brought the administrative interpretation into closer accord with judicial decisions, and not one which, as in our case, completely changed an earlier construction which had been expressly approved by the Courts and had further been given the effect of law by Congress. The *Wilshire* case involved a legislative regulation under Section 23 (l) of the 1928 Revenue Act (i. e., a regulation by which the Commissioner was expressly authorized to fill in the details of the Act) and not a mere interpretative regulation such as is involved in the case at bar. Furthermore, the very section of the law itself had been changed by the Revenue Act of 1926 under which no similar regulation had been promulgated. This Court expressly held that the disputed phrase had thereby been restored "to its original ambiguity." The *Reynolds* case likewise involved the construction of a section of the Act which had just been changed by Congress and where there had been no prior regulation under the two preceding revenue acts.

None of those facts exist in the case at bar and despite some general language of the Court in those cases the holdings in none of them are applicable to or controlling on this case. To permit the opinion of the Circuit Court of Appeals to go uncorrected will do much to add to the already highly confused state of the law on this all important and constantly recurring question.

6.

In Holding That Petitioner Was Dealing In Its Own Shares As It Might In The Shares Of Another Corporation, The Circuit Court Of Appeals Has Sanctioned A Distortion Of The Clear Language And Intent Of The Treasury Regulations Which Should Be Rectified By This Court.

The revised regulation reads as follows [Art. 22 (a)-16 of Regulations 86 and 94]:

"**Acquisition or disposition by a corporation of its own capital stock.**—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the **real nature of the transaction**, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

"But **if a corporation deals in its own shares as it might in the shares of another corporation**, the resulting gain or loss is to be computed in the same manner as though the corporations were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from **such** transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code." (Emphasis Added.)

Even if the validity of the revised regulations were to be conceded, it still would not make the transactions here involved taxable. We have emphasized those portions of the regulations which are material to the case at bar. They are first, that whether or not the sale of capital stock gives rise to taxable income "depends upon the real nature of the transaction," and second, that "if a corporation deals in its own shares as it might in the shares of another corporation" it is an income transaction.

The facts here disclose that the real nature of these transactions was purely capital. These shares were acquired by petitioner at the time of its incorporation pur-

suant to a preincorporation underwriting agreement (R. 19). They were acquired for the sole purpose of ultimate sale or other disposition to petitioner's employees as a means of fostering their loyalty by giving them a proprietary interest in the company (R. 19). The stock of no other corporation could have served that purpose, nor could the stock of any other corporation have been acquired in that manner. The result, for all practical purposes, would have been precisely the same had petitioner originally issued only 95,000 shares or, having acquired the 5,000 shares as it did, had retired them and then had later issued additional shares to its employees pursuant to these employees' stock purchase plan, in which case admittedly there would have been no taxable gain. What was actually done was precisely the same in substance. Only the formal mechanics of the actual transactions were different. In other words, as a practical matter, these shares were exactly the same as authorized but unissued stock.

If it was the intention of the Commissioner in drafting these regulations to tax **every** disposition by a corporation of its own stock other than upon original issue, then there would have been no need for the inclusion in the regulation of the language quoted above. Obviously, the Commissioner and the Treasury Department, in promulgating the revised regulation, contemplated that there **are** certain transactions by a corporation in its own stock, other than the original issuance thereof, which are **really** capital in their nature and which do **not** give rise to taxable gain or deductible loss. If any proof of this proposition be needed, it is found in the fact that the Commissioner has already sought to disallow deductions in cases similar to the one at bar on the theory that in the sale of treasury stock a particular corporation was **not** dealing in its own shares as it might in the shares of another corporation. See

D. N. & E. Walter and Co. v. Commissioner, 1942 B. T. A. Memo. (C. C. H.—B. T. A. Service, Decision 12,576-B).

Yet when the Court holds, as it does in the opinion below, that the manner and purpose of the acquisition and sale by petitioner of its shares are immaterial and beside the point, and that the only thing which is material is the fact that the corporation did purchase these shares and did subsequently sell them, then the effect of the Court's holding is to emasculate the express language of the regulation and to disregard entirely the intention and purpose of the inclusion of the quoted language in the revised regulation.

Coming specifically to that portion of the Circuit Court's opinion which deals with the question of whether or not petitioner was dealing in these shares of its own treasury stock as it might in the shares of another corporation, we call attention to the following language appearing on the last page of the opinion (R. 68):

> "The point is made that the purchase and sale of the shares in another corporation could not satisfy the essential purpose of the employee purchase plan. **This, of course, is true** but immaterial. The material fact is that the corporation bought and sold its own stock at a profit, dealing, in controlling aspects of the transaction, as it might have dealt with the stock of another corporation." (Emphasis ours.)

We submit that this is wholly inconsistent. The Circuit Court concedes that the acquisition and sale of stock of another corporation "could not satisfy the essential purpose of the employee purchase plan." But, the opinion states, this, while perfectly true, is immaterial. How, we submit, can this be immaterial, when this is the determining factor established by the regulation? If the language of the regulation is to have **any meaning at all**, then this factor is not only material, but **determinative** of the issue.

Nor, we submit, does the statement that "the material fact is that the corporation bought and sold its own stock at a profit" meet the issue at all. As a matter of pure logic, this merely begs the question, for the sole issue **is** whether or not this transaction resulted in a "profit" within the meaning of Section 22 (a); and under the literal terms of the revised regulation the transaction does **not** result in a "profit" if the corporation has **not** dealt with its stock as it might with the stock of another corporation. The regulation provides that a taxable profit results only if the corporation deals in its own shares as it might in the shares of another, and admittedly here the corporation could **not** have used the shares of another corporation to accomplish its conceded purpose of fostering the loyalty and proprietary interest of its employees in its business.

Furthermore, the corporation here was not, as the opinion states, "dealing, in controlling aspects of the transaction, as it might have dealt with the stock of another corporation." **Petitioner acquired this stock in a manner in which it could not have acquired the stock of any other corporation.** It acquired these shares pursuant to the original preincorporation underwriting agreement of the original incorporators. **It could not have acquired the stock of any other corporation in that manner.** We submit again, therefore, that **in no sense** was petitioner dealing in these shares as it might in the shares of another corporation. The controlling aspects are the **method of acquisition** and the **purpose** for which these shares were so acquired and sold. They were, we submit, the same as **authorized but unissued shares**, and this issuance to the employees of the company was, therefore, a purely capital transaction and should be so treated even under the literal words of the revised regulation itself.

Unless it was the intention of the Court of Appeals to completely disregard the intention and purpose of the language of the revised regulation, we must assume that

the Court, on this phase of the case, simply overlooked the fact that **petitioner here neither purchased any of its own shares on the open market nor ever sold any of its own shares on the open market.** The corporation could have done what it did with the stock of only one corporation and that was the stock of Edison Brothers Stores, Inc.; namely, its own shares. Therefore, if the Circuit Court meant to hold, as it apparently does on the last page of its opinion, that the controlling aspect of the transactions involved is the mere fact that there has been a purchase and a later sale by the corporation of its own shares at a different price, then that Court has entirely overlooked the controlling language of the revised regulation as well as the purpose and intention of that language, and in so doing has fallen into serious error on a matter of federal law which should be corrected by this Court.

CONCLUSION.

For all of the reasons set forth in the petition and supported by the argument and authorities cited in this brief, we respectfully submit that this case is one calling for the exercise by this Court of its supervisory powers in order that the various conflicts and errors herein pointed out may be corrected, and to that end we strongly urge that the petition for a writ of certiorari be granted.

Respectfully submitted,

J. SYDNEY SALKEY,
SAM ELSON,
PETER H. HUSCH,
Attorneys for Petitioner.

Of Counsel:

SALKEY & JONES,
506 Olive Street,
St. Louis, Missouri.

April 10, 1943.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes and regulations involved	2
Statement	4
Argument	6
Conclusion	10

CITATIONS

Cases:	
Allen v. *National Manufacture & Stores Corp.*, 125 F. 2d 239, certiorari denied, 316 U. S. 679	8
Commissioner v. *Air Reduction Co.*, 130 F. 2d 145, certiorari denied, November 16, 1942, No. 456, this Term	8, 11
Douglas v. *Willcuts*, 296 U. S. 1	9
First Chrold Corp. v. *Commissioner*, 306 U. S. 117	6, 7
Helvering v. *Reynolds*, 313 U. S. 428	7
Helvering v. *Reynolds Co.*, 306 U. S. 110	6, 7
Helvering v. *Stockholms &s. Bank*, 293 U. S. 84	9
Helvering v. *Wilshire Oil Co.*, 308 U. S. 90	7
Investment Corp. v. *United States*, 43 F. Supp. 64	8
Irwin v. *Gavit*, 268 U. S. 161	9
Merchants' L. & T. Co. v. *Smietanka*, 255 U. S. 509	9
Stern Bros. & Co. v. *United States*, 45 F. Supp. 583	8
Trinity Corp. v. *Commissioner*, 127 F. 2d 604, certiorari denied, October 12, 1942, No. 220, this Term	8
United States v. *Safety Car Heating Co.*, 297 U. S. 88	9
Statutes:	
Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 22	2
Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 22	3
Miscellaneous:	
Constitution of the United States, Sixteenth Amendment	
T. D. 4430, XIII–1 Cum. Bull. 36 (1934)	7
G. C. M. 16651, XV–2 Cum. Bull. 130 (1936)	10
Treasury Regulations 86, Art. 22 (a)–16	3
Treasury Regulations 94, Art. 22 (a)–16	4

524310—43

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 916

EDISON BROTHERS STORES, INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 26–33) is reported in 45 B. T. A. 472. The opinion of the United States Circuit Court of Appeals (R. 56–68) is reported in 133 F. 2d 575.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 3, 1943 (R. 69–70). The petition for rehearing was denied on March 3, 1943 (R. 83). The petition for a writ of certiorari was filed on April 12, 1943. The jurisdiction of this

Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Where a corporation, in 1935 and 1937, sells its own stock, previously acquired for the purpose, to its employes at a profit, whether the profit constitutes income within the meaning of Section 22 (a) of the Revenue Acts of 1934 and 1936 and the applicable Treasury Regulations.

2. Whether Article 22 (a)–16 of Treasury Regulations 86 and 94, promulgated under the Revenue Acts of 1934 and 1936, respectively, is valid.

3. Where the taxpayer satisfied a debt owing to its general counsel for services rendered by the transfer to counsel of shares of its capital stock which it had acquired at a cost less than the fair market value at the time of transfer, whether the taxpayer realized taxable income under Section 22 (a) of the Revenue Acts of 1934 and 1936 and the applicable Treasury Regulations. This depends upon the answers to the first and second questions.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions,

> vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

The corresponding provision of the Revenue Act of 1936, c. 690, 49 Stat. 1648, is the same.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

> ART. 22 (a)–16. *Acquisition or disposition by a corporation of its own capital stock.*— Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.
>
> But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the cor-

> poration receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Act.

Article 22 (a)–16 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, is the same.

STATEMENT

The facts, as stipulated (R. 18–26), and as found by the Board of Tax Appeals (R. 27–31), may be summarized as follows:

The taxpayer was incorporated in 1925, under the laws of Delaware, by the five Edison brothers who subscribed for and acquired the entire issue of 100,000 shares of its no par value common stock. Its principal office is located in St. Louis, Missouri. (R. 27.)

In 1929 the taxpayer reacquired from the five Edison brothers 5,000 shares of its stock at $15 per share for the purpose of sale and distribution to its employees; and the 5,000 shares which were held by the taxpayer in its treasury were designated in its annual statement as "Capital stock purchased for resale to employees" (R. 27).

During 1935, the first of the taxable years, the

taxpayer sold 980 shares of its common stock to certain of its key employees at a price of $25 per share. The Commissioner determined that in 1935 the taxpayer realized a gain in the amount of $10 per share or an aggregate amount of $9,800, representing the difference between the price which the taxpayer paid for the stock and the price which it received for the stock from its employees. (R. 29.)

In 1935 the taxpayer transferred 100 shares of its stock, previously purchased from its stockholders, to an attorney in payment of his bill of $3,000 for legal services rendered. At the time of this transfer the stock had a fair market value of $3,000. The taxpayer claimed a deduction of $3,000 in its tax return for 1935, but the Commissioner allowed a deduction of only $1,500, the cost to the taxpayer of the 100 shares in question. (R. 28.)

In 1937, the second of the taxable years, the taxpayer allotted and sold to certain of its employees 3,660 shares of its common stock at a price of $15 per share; taxpayer's cost basis for that stock was $5 per share (R. 30). The Commissioner determined that in 1937 the taxpayer realized a gain of $10 per share or an aggregate amount of $36,600, representing the difference between the price which the taxpayer paid for the stock and the price at which it was sold to its employees (R. 31).

The Board of Tax Appeals decided that the taxpayer realized no taxable gain from the sale of its stock to its employees in 1935, but that it did realize gains on such transactions in 1937. It also decided that the taxpayer realized no taxable gain when it paid its counsel with 100 shares of its stock with a fair market value of $3,000, but which cost the taxpayer only $1,500. (R. 31–32.) Both sides appealed to the Circuit Court of Appeals for the Eighth Circuit; the taxpayer appealed as to the year 1937 and the Commissioner as to the year 1935. The Circuit Court of Appeals decided that, with respect to both the year 1935 and the year 1937, all of the gains realized from the sale of taxpayer's own stock, previously acquired for the purpose, represented taxable income.

ARGUMENT

1. One of the reasons relied on by the petitioner for granting the writ in this case is that the decision of the Court below conflicts directly with the decisions of this Court in *Helvering* v. *Reynolds Co.*, 306 U. S. 110, and in *First Chrold Corp.* v. *Commissioner,* 306 U. S. 117.

In the *Reynolds Co.* case the corporation, in 1929, sold some of its stock, previously purchased from its stockholders, at a profit. During the year 1929 the Treasury Regulations provided in part that a corporation realizes no gain or loss from the purchase or sale of its own stock. That regulation had been in effect for a number of

years, but was amended by T. D. 4430, XIII–1 Cum. Bull. 36, approved May 2, 1934, so that it provided in part that whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all the facts and circumstances. It also provided that if a corporation deals in its own shares as it might in the shares of another corporation the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. The *First Chrold* case did not differ in any material respect and involved the tax year 1933.

This Court held that the amended regulation promulgated in 1934 could not properly be applied to transactions that took place in the year 1929 (*Reynolds Co.* case) or in 1933 (*First Chrold* case). In this case the transactions took place in 1935 and 1937, after the promulgation of T. D. 4430, so that here the Commissioner is applying the amended regulation prospectively and not retroactively. Consequently, this case differs materially from the *Reynolds Co.* and *First Chrold* cases. This Court has decided that regulations may be changed and applied prospectively. *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 100–101; *Helvering* v. *Reynolds*, 313 U. S. 428, 432.

After this Court decided the *Reynolds Co.* case a number of courts upheld the validity of the regu-

lations in question as applied prospectively and this Court has within the past year denied petitions for writs of certiorari in three of the cases. *Allen* v. *National Manufacture & Stores Corp.*, 125 F. 2d 239 (C. C. A. 5th), certiorari denied, 316 U. S. 679; *Trinity Corp.* v. *Commissioner*, 127 F. 2d 604 (C. C. A. 5th), certiorari denied, October 12, 1942, No. 220, this Term; *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145 (C. C. A. 2d), certiorari denied, November 16, 1942, No. 456, this Term; see also *Investment Corp.* v. *United States*, 43 F. Supp. 64 (E. D. Pa.).

The only decision to the contrary is *Stern Bros. & Co.* v. *United States*, 45 F. Supp. 583 (W. D. Mo.), in which a corporation in 1936 sold treasury stock to its employees at a profit. That case is now pending on appeal to the court below so that the decision in the instant case would probably control the *Stern Bros.* case and require a reversal of the judgment of the District Court.

2. The decision of the court below in upholding the Treasury Regulations would seem to be correct. If a corporation deals in its own stock as though it were property, that is, if it buys its stock for the purpose of selling it and not for the purpose of retiring it, the transaction may result in gain or loss. If it results in gain, it would appear to be income under the Sixteenth Amendment and under Section 22 (a) of the Revenue Act. The broad language of Section 22 (a) has repeatedly

been noted by this Court. *Irwin* v. *Gavit,* 268 U. S. 161, 166; *Douglas* v. *Willcuts,* 296 U. S. 1, 9; *United States* v. *Safety Car Heating Co.,* 297 U. S. 88, 93; *Helvering* v. *Stockholms &s. Bank,* 293 U. S. 84, 89.

The definition of income in the statute is intended to embrace whatever is commonly understood as income, and it is essentially coextensive with the scope of Congressional power under the Constitution. See *Merchants' L. & T. Co.* v. *Smietanka,* 255 U. S. 509, 519. In this case the taxpayer-corporation realized a gain in cash upon the sale of treasury stock to its employees in the amount of the excess of receipts from the sale of its stock over their cost to the taxpayer-corporation without any attendant change in the number or nature of its shareholding accounts. This is a typical case of realized corporate gain as commonly understood.

3. The petitioner argues that the treasury stock which was sold to its employees was the same as authorized but unissued stock and, therefore, the issuance of its stock to its employees was a purely capital transaction (Br. 28–31). But the difference between what was done in this case and what would have been done in the case of retirement is more than a difference in form. Important legal and practical distinctions are involved. The purchase by a corporation of its shares without retirement enables it to sell them without observing the preemptive right of shareholders; to sell

them without conformity to statutory or charter requirements that a reduction in capital stock be effected by a vote of the board of directors and of stockholders, and the filing of public notice. A corporation which is enabled to secure these advantages by refraining from retiring the stock cannot properly urge that what it did was tantamount to retirement and reduction of capital.

The Second Circuit, in the *Air Reduction Co.* case, held that under circumstances similar to those in this case the corporation was dealing in its own stock as though it were the stock of another corporation. See also, G. C. M. 16651, XV–2 Cum. Bull. 130 (1936).

CONCLUSION

The decision of the court below is correct and there is no conflict of decisions. It is, therefore, respectfully submitted the petition for writ of certiorari should be denied.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, Jr.,
Assistant Attorney General.
SEWALL KEY,
MORTON K. ROTHSCHILD,
Special Assistants to the Attorney General.

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